

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
ALEX AND ANASTASIA DEMETRIADES	:	DETERMINATION
	:	DTA NO. 818011
for Redetermination of a Deficiency or for Refund of	:	
New York State and New York City Personal Income	:	
Taxes under Article 22 of the Tax Law and the New York	:	
City Administrative Code for the Years 1987, 1988 and	:	
1989.	:	

Petitioners, Alex and Anastasia Demetriades, 78-08 221st Street, Bayside, New York 11364, filed a petition for redetermination of a deficiency or for refund of New York State and New York City personal income taxes under Article 22 of the Tax Law and the New York City Administrative Code for the years 1987, 1988 and 1989.

A small claims hearing was held before Brian L. Friedman, Presiding Officer, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on May 28, 2002 at 1:15 P.M., with all briefs to be submitted by September 20, 2002, which date began the three-month period for the issuance of this determination. Petitioners appeared by Jeff Pearlman, CPA. The Division of Taxation appeared by Barbara G. Billet, Esq. (Oji C. Reed).

ISSUE

Whether, as a result of an audit by the Internal Revenue Service which took more than five years to complete, interest and penalties asserted to be due by the Division of Taxation on deficiencies resulting from petitioners' failure to report Federal changes ensuing from this audit, should be abated.

FINDINGS OF FACT

1. On October 1, 1998, the Division of Taxation (“Division”) issued a Notice of Additional Tax Due to Alex and Anastasia Demetriades (“petitioners”) which asserted a deficiency for the year 1987 as follows:

	Tax	Interest	Penalty	Balance Due
New York State	13,821.52	17,375.55	2,902.48	34,099.55
New York City	6,431.12	8,084.80	1,350.48	15,866.40
TOTALS	20,252.64	25,460.35	4,252.96	49,965.95

2. On October 1, 1998, the Division issued a Notice of Additional Tax Due to petitioners which asserted a deficiency for the year 1988 as follows:

	Tax	Interest	Penalty	Balance Due
New York State	20,441.03	22,422.05	5,365.75	48,228.83
New York City	8,542.52	9,370.41	2,242.35	20,155.28
TOTALS	28,983.55	31,792.46	7,608.10	68,384.11

3. On October 1, 1998, the Division issued a Notice of Additional Tax Due to petitioners which asserted a deficiency for the year 1989 as follows:

	Tax	Interest	Penalty	Balance Due
New York State	3,878.91	3,562.80	814.52	8,256.23
New York City	1,674.71	1,538.23	351.64	3,564.58
TOTALS	5,553.62	5,101.03	1,166.16	11,820.81

4. Each Notice of Additional Tax Due contained the following explanation:

Under authorization of section 6103(d) of the Internal Revenue Code, we received notification of federal audit changes. The following deficiency is based on failure to report these changes.

Section 659 of the New York State Tax Law requires taxpayers to report federal changes to New York State within 90 days after final federal determination. This provision of the Tax Law is outlined in the instructions for preparation of New York State income tax forms.

* * *

Section 683(c) of the New York State Tax Law provides for assessment at any time when a taxpayer fails to comply with section 659.

5. The notices of additional tax due informed petitioners that rent or royalty income on their return for each of the years at issue had been corrected to include the Federal adjustment; for the years 1987 and 1988, ordinary income had been corrected to include the Federal adjustment.¹ The notices also indicated that penalty for late filing, pursuant to Tax Law § 685(a)(1), had been imposed at 5 percent per month up to a maximum of 25 percent and that interest at the applicable rate, required under the Tax Law, had also been imposed for late payment or underpayment.

6. Petitioners did not file timely New York State returns for the years at issue, to wit, the 1987 return was filed on November 17, 1988 and the 1988 and 1989 returns were filed on August 15, 1990.

7. On July 11, 1996, the Internal Revenue Service ("IRS") issued Income Tax Examination Changes to petitioners which asserted an income tax deficiency in the amount of \$58,479.00 for 1987, \$47,549.00 for 1988 and \$16,761.00 for 1989 (a delinquency penalty in the amount of \$4,849.26 was imposed pursuant to section 6651[a] of the Internal Revenue Code for

¹ For 1988, the notice further stated that petitioners' itemized deductions had been corrected to include the Federal adjustment.

the year 1987 for petitioners' failure to timely file their return for that year). On July 17, 1996, petitioners' representative, Jeff Pearlman, CPA, signed a consent on behalf of petitioners whereby he agreed to the immediate assessment and collection of the increases in tax and penalties.

8. Petitioners did not report these Federal changes to the Division.

9. On June 5, 1997, petitioners' representative sent a letter to the IRS which stated as follows:

I am seeking to open the case for 1987, 1988 and 1989 because there are a number of issues that may have been incorrectly reported for these years. I had written several letters to the auditor to review the respective files but no contact was ever received. I believe the agent may have resigned due to poor health. My client has already paid over \$35,000 on account and a 1040X is being filed for 1991 and 1992 on a carryback loss for 1994. This will reflect refunds of \$20,000.

Please afford me the opportunity to review the file and determine if the tax and respective interest was calculated correctly.

10. On July 17, 1997, petitioners filed an amended Federal return for the 1988 tax year on which they deducted \$101,550.00, thereby reducing total tax due for the year from \$71,024.00 per the Income Tax Examination Changes to \$39,855.00. On the return, petitioners stated that while the IRS had eliminated \$101,550.00 from deductions of \$118,700.00, the examination indicated no change.

By letter dated May 19, 1998, the IRS stated, in relevant part, as follows:

We are enclosing a copy of the Adjustment Report showing the items adjusted and the amounts. Please be advised that after numerous requests we were unable to obtain from the Service Center the 1987 casefile containing the workpapers and balance sheets showing the Revenue Agent's computations for all the years adjusted.

We secured the 1988 and 1989 casefiles. But, these two files only contained copies of the Adjustment Report and notes indicating that all workpapers and mathematical computations were filed in the 1987 case.

However, we feel that the Adjustment Report provides you with sufficient information pertaining to the items in question during your audit.

11. In summary, the Revenue Agent of the IRS found that petitioners sold rental property in 1986 on an installment method, but failed to report income on tax returns for the years 1987, 1988 and 1989. Some amounts had been reported as interest, however. The Revenue Agent further found, when auditing a corporation (Alex Furs, Inc.) which was owned by petitioners, that the corporation had on its balance sheet many of the same entities that were shown on petitioners' Schedule E (Supplemental Income and Loss From Rents, Royalties, Etc.). The agent thereupon made adjustments which reduced the bases for these entities and disallowed losses shown on petitioners' returns for the years at issue. There were additional adjustments (primarily relating to depreciation expenses claimed) resulting from intercorporate transactions between corporations which were wholly owned by petitioners.

12. By letter dated January 8, 1999, in response to petitioners' inquiry concerning the tax deficiencies for the years at issue, the Division advised petitioners as follows:

Upon review of your correspondence, we have corrected our records and adjusted your balance of tax due as indicated in the attached Computation Summary Section. The interest and additional charges have also been recomputed.

Based on recent federal information which we have obtained, the 1987 federal tax was increased by \$58479.00. This was the result of an increase of \$155746.00 to your 1987 income. The adjustments were \$130770.00 to schedule E rents and \$24976.00 to other gains and losses.

Your 1989 federal tax was increased by \$16761.00 as a result of a \$49256.00 adjustment to schedule E rents.

Since you have not provided IRS documentation that the 1987 and 1989 federal tax increases were revised or withdrawn, the 1987 and 1989 bills are sustained.

The 1988 bill is being revised based on a \$29215.00 reduction in your federal tax bill resulting in a \$55558.00 adjustment to your NY income as follows:

	State	City	
NY Adjusted gross income reported	\$211256.00		
Federal adjustment	55558.00		
NY adjusted gross income corrected	266814.00		
NY itemized deductions	100464.00		
Balance	166350.00		
Dependent exemptions	2000.00		
NY taxable income	164350.00		
Tax on above	12893.00	5307.00	Total tax
Tax previously stated	10626.79	3362.72	due \$4210.49

13. Petitioners paid the tax liabilities for each of the years at issue, to wit, \$20,252.64 for 1987, \$4,210.49 for 1988 and \$5,553.62 for 1989. As of May 24, 2002, penalty of \$4,772.55 and interest of \$35,710.43, for a total of \$40,482.98 was due and owing for 1987. For 1988, penalty in the amount of \$1,105.19 and interest in the amount of \$6,582.80, or a total of \$7,687.99 was due and owing. For 1989, penalty of \$1,311.81 and interest of \$7,368.09, or a total of \$8,6679.90 was due and owing.

14. The IRS, on March 14, 1991, furnished the Division with a Literal Transcript for the years 1987, 1988 and 1989 for petitioners; no reduction of penalty or interest is indicated thereon.

SUMMARY OF THE PARTIES' POSITIONS

15. Petitioners contend that the IRS audit took an excessive amount of time (more than five years) to complete. The IRS agent who handled the matter, Gail Percoco, had hepatitis and, accordingly, could not complete the audit in a timely manner. Petitioners also allege that as a result of the delay in completing the audit, Ms. Percoco stated that she would reduce the penalty and interest assessed against petitioners.

On numerous occasions, petitioners' representative, Jeff Pearlman, CPA, asked the IRS to review petitioners' case but has been unsuccessful in resolving the matter and since the IRS agent did not prepare the necessary documentation, he has been unable to file amended returns for each of the years at issue.

Petitioners accept the interest and penalty for all years after 1996, but maintain that since the Federal audit should not have taken more than three or four years, penalty and interest for the years between 1990 and 1996 should be partially abated, i.e., two years of penalty and interest (for 1995 and 1996) should be abated due to the unreasonable period of the Federal audit.

16. The Division states that the IRS transcripts furnished to the Division show no abatement of penalty and interest due to unreasonable delay. Even assuming that there was an unreasonable delay due to ministerial acts on the part of the IRS, such acts cannot be imputed to the Division since they were not performed by employees of the Division. The Division further maintains that petitioners failed to timely file accurate returns for the years at issue. Moreover, petitioners consented to the IRS audit on July 17, 1996 and thereupon failed to report the Federal changes to the Division as required by Tax Law § 659.

CONCLUSIONS OF LAW

A. Tax Law § 659 provides that if the amount of a taxpayer's Federal taxable income is changed or corrected by the United States Internal Revenue Service, the taxpayer shall report such change or correction within 90 days after the final determination of such change or correction and shall concede the accuracy of such determination or state wherein it is erroneous.

B. Petitioners did not comply with the provisions of Tax Law § 659 by notifying the State of New York of the changes to their Federal taxable income resulting from their having signed a consent to the Federal changes on July 17, 1996.

C. IRC § 6404(e)(1) provides for the abatement of interest on any deficiency attributable in whole or in part to any unreasonable error or delay by an officer or employee of the IRS, acting in his official capacity, in performing a ministerial or managerial act. It must be noted that there is no evidence in the record that the IRS agreed to the abatement of interest resulting from the alleged delay, by its agent, in concluding petitioners' Federal audit. Moreover, even if the IRS does, in fact, agree that there was an unreasonable delay by one of its officers or employees, that delay cannot be imputed to the Division.

D. Tax Law § 3008(former [a]), which was applicable to interest which accrued prior to September 10, 1997, provided as follows:

Interest attributable to errors and delays by the department. (1) In the case of any assessment or final determination of interest on:

(A) any deficiency or any tax finally determined to be due attributable in whole or in part to any error or delay by an officer or employee of the department (acting in his or her official capacity) in performing a ministerial act, or

(B) any payment of any tax to the extent that any error or delay in such payment is attributable to such officer or employee being erroneous or dilatory in performing a ministerial act, the commissioner may abate the assessment or final determination of all or any part of such interest for any period.

Petitioners were required, pursuant to the provisions of Tax Law § 659, to report the changes to their Federal taxable income resulting from their having consented to such changes on July 17, 1996. Since, for purposes of the State and City personal income taxes, petitioners' New York adjusted gross income means their Federal adjusted gross income with certain modifications not relevant herein, any changes to their Federal taxable income which increased such Federal taxable income (and, accordingly, increased their Federal tax liability for the years at issue) resulted in similar changes to their New York adjusted gross income with increases to

their State and City tax liabilities for these years as well. The penalties and interest assessed on the State and City tax deficiencies resulting from these changes to petitioners' Federal taxable income accrued as a result of petitioners' failure to timely report the Federal adjustment and remit additional tax due to the State based upon such adjustment. The failure to remit the additional tax due gave petitioners the use of funds which did not belong to them and deprived the State of funds which belonged to it. The interest imposed upon the outstanding amount of tax due compensated the State for its inability to use the funds (*see, Matter of Mauceri*, Tax Appeals Tribunal, May 13, 1993). Since there is no evidence that the interest accrued on the tax deficiencies as a result of the error or delay by an employee of the Tax Department, there is no basis for an abatement of interest on these deficiencies.

E. With respect to the penalties which were imposed pursuant to Tax Law § 685(a)(1), abatement of these penalties requires proof by petitioners that their failure to file was due to reasonable cause and not due to willful neglect. Such proof is absent in the present matter. Petitioners have provided no reason for their failure to comply with the provisions of Tax Law § 659 which required them to report the Federal changes to the Division within 90 days. While they allege certain irregularities by the IRS agent, even if true, this clearly does not constitute reasonable cause for their failure to comply with Tax Law § 659. Accordingly, penalties imposed shall not be abated.

F. The petition of Alex and Anastasia Demetriades is denied and the Notices of Additional Tax Due issued by the Division on October 1, 1998, as modified by Finding of Fact "13", are hereby sustained.

DATED: Troy, New York
December 19, 2002

/s/ Brian L. Friedman
PRESIDING OFFICER